

Ec 317
Labour Economics
2005-2006

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Course Web Page: <http://econ.lse.ac.uk/courses/ec317/>

Time and Location: Lectures: Friday 9:30-11:00, D311
Classes: TBA

There will be 30 hours of lectures and 15 hours of classes.

Office Hours: Steve Pischke Monday 10:00-12:00
Fabian Waldinger TBA

Course Description: This course is an introduction to the economic analysis of behavior and institutions in the labor market. The purpose of this course is threefold. We will learn how microeconomic models are applied to labor market phenomena, such as labor supply and participation, labor demand by firms, and wage determination under different institutional settings. Labor economics is a very empirical field. The second goal is therefore to examine how to distinguish alternative theories empirically and how key parameters of the models are obtained from the data. This will involve students doing some of their own data analysis. Thirdly, we will explore how the models can be applied to evaluate labor market policies, such as the minimum wage, reform of the welfare system, or restricting immigration. The goal of this course is to enable students to think independently about labor market issues, drawing on the models and tools developed during the course.

Readings: Borjas, *Labor Economics*, 2nd edition, 2000, 3rd edition, 2005.

Classes and Examinations. There will be (approximately) weekly problem sets, which will be discussed in classes. Some of the problems will involve hands-on data analysis of particular labour market issues. The data will be provided and you will get a lot of guidance what to do. But you will have to go to the computer yourself and use some of the knowledge from your econometrics course to learn first hand how labour economists go about learning empirical facts.

The exam will consist of both problems and essay questions drawing on the material from lectures, problems, and classes.

Course Outline and Annotated Reading List

- denotes required reading [Reference numbers to the library's offprint collection are in square parentheses].

This course outline will guide you through the topics we will cover during the year. It lists the required readings as well as some optional material. In many cases these optional readings will give you an idea where I have obtained the material for the lectures. The lectures will typically give a simplified account of the articles. If you are interested in further study of a certain topic, the listed sources should serve as a good starting point. I have also added some sources that I just found interesting reading, they may interest you as well. You are encouraged to let me know what you liked and what you didn't like.

Introduction to the Labor Market

- Borjas, chapter 1

Labor Supply

The Static Labor Supply Model

- Borjas, chapter 2, through section 2-9.

Extensions: Commuting Cost, Overtime, Moonlighting and Self-Employment

- Ehrenberg and Smith, Modern Labor Economics, 7th edition, 2000, Appendix 6A

The older editions of Ehrenberg and Smith have a good discussion of the money and time costs of working.

Policy Application: Will Welfare Reform Work?

- Borjas, chapter 2, sections 2-10 and 2-11
- Blank, Rebecca, "U.S. Welfare Reform: What's Relevant for Europe?" *CE-Sifo Economic Studies* 49, 2003, 49-74 [P3401a/b].

This paper discusses the US welfare reform in the 1990s, and describes what has been learned from the experience.

- Yelowitz, Aaron “The Medicaid Notch, Labor Supply, and Welfare Participation: Evidence from Eligibility Expansions.” *Quarterly Journal of Economics* 110, November 1995, 909-939

Yelowitz analyzes how extensions of the Medicaid program, medical care for the poor, has changed incentives to participate in welfare versus work for pay during the late 1980s. Health care reform may actually be useful to get mother’s off welfare.

Life-Cycle Labor Supply and Retirement

- Borjas, chapter 3, through section 3-4
- Krueger Alan B., and Jörn-Steffen Pischke, “The Effect of Social Security on Labor Supply: A Cohort Analysis of the Notch Generation.” *Journal of Labor Economics*, October 1992, 412-437

We look at a particular change in the Social Security law in the late 1970s that has led to a decrease in retirement benefits for specific age cohorts. This was the first time in U.S. Social Security history that benefits were cut. We don’t find evidence that this increased the incentive of older men to work more: the trend to earlier retirement continues.

Labor Demand

Competitive Labor Demand of the Firm and the Industry

- Borjas, chapter 4, though section 4-8

The Bigger, the Worse: Monopsony

- Borjas, section 5-6 (2nd ed), section 5-7 (3rd ed)

Policy Application: Minimum Wages – Good or Bad?

- Ehrenberg and Smith, chapter 4, 110-118; Borjas, sections 4-9, 4-10, 5-1, 52.
- Krueger, Alan B. and David Card, *Myth and Measurement: The New Economics of the Minimum Wage*, Princeton University Press 1995

A book that is challenging the conventional wisdom on minimum wage — and makes us wonder how much wisdom labor economists have about low wage labor markets.

- Dolado, Juan et al. “The Economic Impact of Minimum Wages in Europe,” *Economic Policy*, October 1996, 317-357.

Summarizes research on the impact of minimum wages in various European countries.

Policy Application: Is Immigration Bad for the Rest of us?

- Borjas, section 5-4 (2nd ed) section 5-5 (3rd ed.)
- Card, David “The Impact of the Mariel Boat Lift on the Miami Labor Market,” *Industrial and Labor Relations Review*, January 1990, 245-257
More than 100,000 Cubans refugees arrived in Miami during the summer of 1980. While many of them settled permanently in the city, the Cuban’s had surprisingly little impact on the earnings of low skilled native workers.

Dynamic Labor Demand

- Borjas, section 4-11

Wage Determination

The Economics of Schooling: The Human Capital Model

- Borjas, chapter 7, through section 7-3
- Mincer, Jacob *Schooling, Experience, and Earnings*. New York: Columbia University Press, 1974, especially chapters 3, 4, and 5
This is a labor economics classic. Mincer was the first to systematically analyze the relationship between earnings, schooling, and age. He probably discovered one of the most stable empirical relationships in labor economics. Browse for historical interest at your leisure.

The Signalling Model: Why Do LSE Students Have to Work so Hard?

- Borjas, section 7-7 (2nd ed.) section 7-9 (3rd ed.)

The Returns to Schooling: Does All the Toil and Trouble Pay Off?

- Borjas, sections 7-4 to 7-6 (2nd ed.) 7-4 to 7-8 (3rd ed.)
- Angrist, Joshua and Alan B. Krueger, “Does Compulsory School Attendance Affect Schooling and Earnings?” *Quarterly Journal of Economics*, November 1991, 979-1014

If ability confounds our estimates of the returns to schooling we want to look for something that induces students to stay in school longer but something should have no relation to intelligence. Compulsory schooling laws do just that. Given that students are born in different months of the year, some can drop out earlier than others. Angrist and Krueger finds that forcing a student to go to classes another quarter raises earnings by 3 percent. So shouldn't you go to class? The part with the pictures is easy to read, skip the rest.

Earnings Growth Over the Life Cycle: On-the-Job-Training

- Borjas, sections 7-8 to 7-10 (2nd ed.) section 7-10 to 7-12 (3rd ed.)
- Becker, Gary S. *Human Capital*, Chicago: The University of Chicago Press, 3rd ed. 1993, chapter II.

That's what he won the Nobel Prize for! Becker was the first to provide a systematic framework for thinking about training investments.

- Acemoglu, Daron and Jörn-Steffen Pischke “Beyond Becker: Training in Imperfect Labor Markets,” *Economic Journal* 1999, F112-F142 [P7488a/b]
- The problem with Becker's story is that it doesn't seem to fit the actual facts about the financing of training. We try to fix that.*

Efficiency Wages and Labor Contracts: The Economics of Working and Shirking

- Borjas, sections 12-1, 12-4, 12-5
- Milgrom, Paul and John Roberts *Economics, Organization, and Management*, chapter 10

- Lazear, Edward P. "Personnel Economics: Past Lessons and Future Directions," *Journal of Labor Economics* 1999, 199-236

Lazear is one of the pioneers of applying economics to the personnel problems of a firm. Here he argues his case: that managers can learn a lot from some simple economic models.

Tournaments and Races: How Much Should Bill Gates Make?

- Borjas, sections 12-2, 12-3

The Distribution of Earnings

Compensating Differentials: Someone Has to Do the Dirty Work

- Borjas, chapter 6
- Smith, Adam, *The Wealth of Nations*, 1776, chapter 10, part 1, [P6170a/b]
The classic treatment on why wages differ. Smith actually discusses a variety of models, among them what is now called human capital and efficiency wages. He presents these in the language of compensating differentials (and of the 18th century, which makes the reading, let's say, a little different).

Gender and Race: Do Women and Blacks Produce Less?

- Borjas, chapter 10
- Goldin, Claudia, *Understanding the Gender Gap. An Economic History of American Women*. New York: Oxford University Press 1990, chapter 4, [P1736a/b]
Chapter 4 of the book is required reading, but the rest of the book is quite interesting as well. It is relatively easy reading. Goldin gives a nice account of the changing role of women in the labor market, especially chapters 2 and 3 might be of interest.

The Changing Wage Structure: Why Are the Poor Getting Poorer?

- Borjas, chapter 8

- *Journal of Economic Perspectives*, Spring 1997, Symposium on Wage Inequality

Four authors discuss the recent trends in wage inequality in the US and possible explanations based on a) changes in the relative demand for more skilled workers due to technology or trade, b) changes in the supply of different skill groups, and c) changes in economic institutions which impact wage dispersion.

- "Earnings Inequality: Changes in the 1980s." OECD Employment Outlook, July 1993, 157-184

A good summary of the recent literature on earnings inequality. Starting point to find what we know about inequality trends in other countries. Also summarizes some of the things we know about the reasons for rising wage dispersion.

- Pischke, Jörn-Steffen "Labor Market Institutions, Wages, and Investment: Review and Implications," CESifo Economic Studies 51, 1/2005, 47-75.

Tries to make sense of simultaneously increasing wage inequality in the US and high unemployment in Europe.

Getting Organised: Labor Unions

Why Workers Want Unions

- Borjas, chapter 11 through section 11-2

Wage and Employment Determination in Unionized Labor Markets

- Borjas, sections 11-3 to 11-5

Bargaining and Strikes

- Borjas, section 11-6

What Do Unions Really Do?

- Borjas, sections 11-7 and 11-8

- Freeman, Richard B. and James L. Medoff *What Do Unions Do?* New York: Basic Books 1984, chapter 6 [P10525a/b]

The voice theory of unions is an important alternative to traditional economic explanations based solely on the role of unions in bargaining over wages and benefits. The authors present evidence for their approach in a popular book.